



COST Workshop on “The Impact of Emerging Multinationals on Global Development”

30 May 2013, Milan

 **POLITECNICO DI MILANO**



The effect of technological intensity and institutional distance on the cross-border investments by emerging multinational companies

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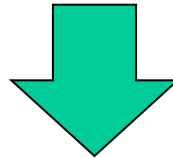
Introduction: what's this paper about?

- The entry mode choice (namely, ownership choice in M&As) in foreign countries by Emerging Multinational Companies (EMNCs) vs. Advanced Multinational Companies (AMNCs)
- in advanced countries
- **Why there should be a difference?**
 - The institutional and economic environment differ
 - The ownership advantages (FSAs) differ



Conceptual background

- MNCs entering a foreign country suffer from *liability of foreignness*, i.e. uncertainty related to the context they are not familiar with



- They prefer lighter commitments, higher flexibility (possibly maintaining a local partner)
- This is particularly true for EMNCs that, in addition to *liability of foreignness*, also suffer from *liability of origin*



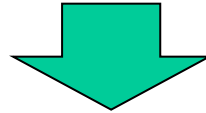
Conceptual background

- Liability of origin (or negative country of origin image) can make the EMNCs' acquisition of legitimacy in the advanced host country market far more difficult
- EMNCs are often subject to discrimination by competitors, consumers and even by governments in advanced markets, due to prevailing biases against practices, products and services associated with emerging economies, to geopolitical considerations, or to a lack confidence in EMFs' capabilities.



Hypothesis 1

- Given that EMNCs suffer not only from a liability of foreignness, but also have a liability of origin, they are likely to suffer from higher uncertainty.



Hypothesis 1

EMNCs will acquire lower equity control than AMNCs



Additional uncertainty – industrial dimension

- Additional uncertainty arise in high technology sectors, due to the difficulties to codify the characteristics of products and technologies by the investing company (and to the lack of adequate absorptive capacity)



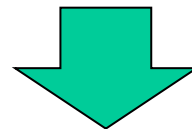
Hypothesis 2

Hypothesis 1 is strengthened in high tech industries



Additional uncertainty – institutional dimension

- Uncertainty may arise also from institutional distance (Zhao et al., 2004)
- The organizational legitimacy perspective argues that in a very unfamiliar environment, MNEs from more dissimilar institutional environments tend to share ownership with a local partner in exchange for adaptation to the external environment (Zaheer, 1995).



Hypothesis 3

MNCs will acquire lower control when institutional distance is higher

- The direction of distance is crucial (Zaheer et al., 2012).
- Thus, contrary to previous evidence about the impact of institutional distance on the MNC entry mode choice, we expect that EMNCs investing in developed countries do not need to rely on a local partner to reduce uncertainty, and are more likely to adopt more control.



Hypothesis 4

Hypothesis 3 does not hold when acquirers come from emerging economies



- Sample: 451 acquisitions undertaken by foreign MNCs in Italy between 2001 and 2010 in 78 manufacturing industries (Reprint Database – Politecnico di Milano).
- 93 acquisitions by EMNCs, 358 by AMNCs.

$$\text{Degree of Ownership}_i = \beta_0 + \beta_1 \text{Emerging}_i + \beta_2 \text{Target Tech Industry}_i + \beta_3 \text{Institutional Distances}_i + \beta_4 \text{Controls} + \varepsilon_i$$



Dependent variable

Degree of Ownership	EMNCs	AMNCs	Total
Minority ownership	13	49	62
%	13.98	13.69	13.75
Equal Ownership	15	9	24
%	16.13	2.51	5.32
Majority ownership	20	50	70
%	21.51	13.97	15.52
Full ownership	45	250	295
%	48.39	69.83	65.41
Total	93	358	451

Degree of Ownership takes value $k=0, 1, 2, 3$, for minority, equal, majority and full ownership, respectively

- Dummy *Emerging*: taking value of 1 if the parent company come from a country classified as emerging by IMF
- *Target Tech Industry*: dummy taking value of 1 if the industry of the target firm is classified as high-tech by OECD
- Institutional Distances: Kogut and Singh (1988) formula to compute an index for each of the items provided by the Heritage Foundation

$$Institutional\ Distance_j^i = \frac{(I_j^i - I_{Italy}^i)^2}{V_i}$$

- Controls: target size (employees), parent tech (OECD), parent local experience (dummy)
- Econometric model: robust ordered probit



Hypothesis 1: Yes

	(1)	(2)	(3)	(4)
Emerging	-0.660*** (-3.56)	-0.569* (-2.46)	-0.680** (-2.68)	-1.040*** (-4.62)
Target Tech Industry	0.059 (0.35)	0.091 (0.56)	0.110 (0.70)	0.090 (0.57)
Institutional distance items:				
Property rights	0.395*** (4.50)			
Freedom from corruption		0.147 (1.69)		
Fiscal Freedom			-0.009 (-0.25)	
Government Spending				0.118* (2.33)
Size	-0.117*** (-5.54)	-0.113*** (-4.57)	-0.105*** (-4.33)	-0.096*** (-4.00)
Parent Tech Industry	0.258 (1.20)	0.301 (1.41)	0.285 (1.35)	0.237 (1.05)
Local Experience	-0.061 (-0.42)	-0.135 (-0.91)	-0.140 (-0.87)	-0.080 (-0.55)
Constant cut1	-2.236*** (-4.64)	-2.392*** (-4.46)	-2.617*** (-5.34)	-2.490*** (-5.23)
Constant cut2	-1.986*** (-4.10)	-2.147*** (-4.00)	-2.373*** (-4.83)	-2.243*** (-4.70)
Constant cut3	-1.430** (-2.93)	-1.603** (-2.94)	-1.833*** (-3.69)	-1.695*** (-3.52)
Time Dummies	yes	yes	yes	yes
N	451	451	451	451
chi2	157.496	151.647	163.009	128.197
p	0.000	0.000	0.000	0.000

* p<0.05, ** p<0.01, *** p<0.001



Hypothesis 2: Yes

	(1)	(2)	(3)	(4)
Emerging	-0.499*	-0.429	-0.556*	-0.904***
	(-2.45)	(-1.78)	(-2.10)	(-3.83)
Target Tech Industry	0.289	0.292	0.305	0.310
	(1.50)	(1.51)	(1.64)	(1.66)
Institutional distance items:				
Property rights	0.408***			
	(4.83)			
Freedom from corruption		0.149		
		(1.75)		
Fiscal Freedom			-0.005	
			(-0.14)	
Government Spending				0.124*
				(2.45)
Size	-0.128***	-0.123***	-0.114***	-0.106***
	(-5.86)	(-4.82)	(-4.65)	(-4.38)
Parent Tech Industry	0.255	0.300	0.285	0.233
	(1.20)	(1.42)	(1.36)	(1.04)
Local Experience	-0.034	-0.114	-0.120	-0.055
	(-0.23)	(-0.76)	(-0.74)	(-0.37)
Emerging* Target Tech Industry	-0.655*	-0.559*	-0.549	-0.617*
	(-2.31)	(-1.99)	(-1.92)	(-2.26)
Constant cut1	-2.107***	-2.303***	-2.532***	-2.395***
	(-4.42)	(-4.33)	(-5.17)	(-5.01)
Constant cut2	-1.855***	-2.058***	-2.287***	-2.147***
	(-3.88)	(-3.87)	(-4.65)	(-4.47)
Constant cut3	-1.298**	-1.513**	-1.747***	-1.598**
	(-2.68)	(-2.79)	(-3.50)	(-3.29)
Time Dummies	yes	yes	yes	yes
N	451	451	451	451
chi2	160.846	162.397	197.814	178.114
p	0.000	0.000	0.000	0.000

* p<0.05, ** p<0.01, *** p<0.001



Hypothesis 3 and 4: Yes...

	(5)	(6)	(7)	(8)	(9)
Emerging	-0.761* (-2.42)	-0.748** (-2.86)	-0.905*** (-3.46)	-1.095*** (-3.92)	-1.321*** (-3.72)
Target Tech Industry	0.095 (0.59)	0.101 (0.64)	0.115 (0.73)	0.078 (0.48)	0.121 (0.77)
Institutional distance items:					
Business Freedom	0.185 (0.97)				
Monetary Freedom		-0.814 (-0.44)			
Trade Freedom			-2.577* (-2.14)		
Investment Freedom				-0.417* (-2.06)	
Financial Freedom					-0.046 (-0.24)
Size	-0.109*** (-4.29)	-0.107*** (-4.92)	-0.103*** (-4.40)	-0.116*** (-4.85)	-0.109*** (-4.93)
Parent Tech Industry	0.257 (1.14)	0.285 (1.29)	0.268 (1.24)	0.253 (1.18)	0.272 (1.30)
Local Experience	-0.122 (-0.80)	-0.136 (-0.84)	-0.168 (-1.03)	-0.027 (-0.17)	-0.083 (-0.53)
Emerging* Institutional Distance	-0.068 (-0.28)	0.824 (0.45)	2.606* (2.16)	0.533* (2.42)	0.336 (1.65)
Constant cut1	-2.541*** (-5.54)	-2.648*** (-5.09)	-2.835*** (-5.49)	-2.740*** (-5.76)	-2.888*** (-5.67)
Constant cut2	-2.296*** (-4.97)	-2.404*** (-4.61)	-2.590*** (-5.01)	-2.496*** (-5.21)	-2.642*** (-5.15)
Constant cut3	-1.754*** (-3.77)	-1.865*** (-3.52)	-2.046*** (-3.91)	-1.949*** (-4.05)	-2.096*** (-4.09)
Time Dummies	yes	yes	yes	yes	yes
N	451	451	451	451	451
chi2	116.158	170.610	127.177	130.209	127.066
p	0.000	0.000	0.000	0.000	0.000

* p<0.05, ** p<0.01, *** p<0.001



Hypothesis 3 and 4: ...and no

	(1)	(2)	(3)	(4)
Emerging	-0.392 (-1.54)	-0.563 (-1.35)	-0.541 (-1.73)	-0.792** (-3.14)
Target Tech Industry	0.065 (0.39)	0.092 (0.57)	0.113 (0.72)	0.091 (0.58)
Institutional distance items:				
Property Rights	0.526*** (4.40)			
Freedom from Corruption		0.147 (1.61)		
Fiscal Freedom			0.044 (0.53)	
Government Spending				0.168* (2.49)
Size	-0.120*** (-5.52)	-0.113*** (-4.62)	-0.102*** (-4.05)	-0.102*** (-4.43)
Parent Tech Industry	0.245 (1.13)	0.301 (1.41)	0.277 (1.30)	0.252 (1.10)
Local Experience	-0.084 (-0.60)	-0.135 (-0.91)	-0.127 (-0.80)	-0.065 (-0.46)
Emerging* Institutional Distance	-0.258 (-1.18)	-0.007 (-0.02)	-0.075 (-0.73)	-0.095 (-1.06)
Constant cut1	-2.001*** (-4.13)	-2.389*** (-4.34)	-2.567*** (-5.26)	-2.419*** (-5.12)
Constant cut2	-1.751*** (-3.61)	-2.145*** (-3.89)	-2.323*** (-4.72)	-2.172*** (-4.61)
Constant cut3	-1.195* (-2.44)	-1.601** (-2.85)	-1.783*** (-3.58)	-1.624*** (-3.40)
Time Dummies	yes	yes	yes	yes
N	451	451	451	451
chi2	158.600	162.892	156.335	132.159
p	0.000	0.000	0.000	0.000

* p<0.05, ** p<0.01, *** p<0.001



Conclusions

- Higher uncertainty (*liability of foreignness + liability of origin*) makes EMNCs more incline (than AMNCs) to adopt a partial ownership as entry mode (in foreign acquisitions)
- Institutional distance leads to different behaviors between AMNCs and EMNCs.
- Need of disentangling institutional distance